AGENDA DATE: 11/24/93

State of New Jersey
Board of Regulatory Commissioners
CN 350
Trenton, NJ 08625-0350

APPLICATION OF JERSEY CENTRAL POWER & LIGHT COMPANY FOR APPROVAL OF THE POWER PURCHASE AGREEMENT BETWEEN JERSEY CENTRAL POWER & LIGHT COMPANY AND FREEHOLD COGENERATION ASSOCIATES, L.P.	)	ELECTRIC
	)	ORDER OF DENIAL
AND	)	DOCKET NO.
VERIFIED PETITION OF FREEHOLD COGENERATION ASSOCIATES, L.P., FOR APPROVAL OF JOINT AGREEMENT BETWEEN BOARD OF REGULATORY COMMISSIONERS STAFF & FREEHOLD COGENERATION ASSOCIATES, L.P.	)	EM92030359

(Service List Attached)

BY THE BOARD:

By letter dated November 3, 1993, Freehold Cogeneration Associates, L.P., ("FCA") petitioned the Board of Regulatory Commissioners ("Board") for approval of a Joint Agreement between the staff of the Board ("Staff") and FCA recommending certain proposed modifications to the

Power Purchase Agreement ("Agreement between Jersey Central Power and Light Company ("JCP&L" or "Company") and FCA previously approved by the Board by Order dated July 8, 1992.

FCA is a New Jersey limited partnership whose general partners are Advanced Power Systems, Inc. and Constellation Energy Inc., an affiliate of Baltimore Gas & Electric Company, which proposes to own, operate and maintain a 110 megawatt (MW) cogeneration facility ("Facility") at the Nestle Beverages Company plant ("Nestle") in Freehold, New Jersey. The Facility will be a Public Utilities Regulatory Policies Act ("PURPA") qualifying facility ("QF") under Federal Energy Regulatory Commission guidelines. The Agreement provides for FCA to deliver 100 MW of electric capacity and associated energy to JCP&L, and steam and possibly native load electricity to Nestle.

The Facility will use natural gas as a primary fuel with fuel oil as the probable backup fuel. The Facility will be a combined cycle facility using a combustion turbine, a heat recover steam generator and a steam turbine.

The Agreement begins on the date of regulatory approval and continues for 20 years from the commercial operation date, which is anticipated to be 48 months after the date of regulatory approval. The commercial operation date may be extended due to force majeure events without penalty, and for up to three years by making payments into a liquidated damages fund.

Background:

In early 1988, pursuant to the then-effective cogeneration policies of the Board of Public Utilities ("BPU"), predecessor agency to the Board, Enserch Development Corporation and its partner, Turner Power

Corporation, the original developers of the project, commenced negotiations on a power purchase agreement with JCP&L. During the pendency of those negotiations, the BPU adopted its competitive bidding guidelines (BPU Docket No. 8010-687B, Order dated September 28, 1988). Competitive bidding effectively replacing negotiations as the means of procuring long-term electric capacity and energy power purchase agreements with non-utility generators.

Concurrent with the adoption of its competitive bidding guidelines, the Board approved a list of projects that were grandfathered from competitive bidding. (Docket No. 8010-687B, Order dated September 28, 1988) The grandfathered cogeneration projects had all reached an agreement on price with the utility, and were permitted to finalize power purchase agreements without being required to go through a competitive bid process.

FCA was not on the original list of projects grandfathered by the BPU. FCA therefore filed a Motion for Reconsideration asking the BPU to reconsider its decision to not grandfather the project. The BPU subsequently issued an Order grandfathering the project or reconsideration. In grandfathering the project from competitive bidding, however, the BPU determined that the project's pricing should not exceed an avoided cost cap used by JCP&L in its 1989 RFP. (Docket No. 8010-687B, Order dated July 31, 1989)

Subsequent to the FCA project being grandfathered, FCA and JCP&L spent over two years negotiating a power purchase agreement. A power purchase agreement was ultimately agreed to and submitted to the Board for approval on March 31, 1992. By written Order dated July 8, 1992, the Agreement was approved by the Board. The pricing in the agreement was equal to the maximum level ordered by the Board in its grandfathering order, which is the price cap used in JCP&L's 1989 RFP.

Since the Board's original grandfathering Order and subsequent approval of the FCA Agreement, two significant events have occurred. The first is that avoided costs have dropped significantly. Second, Public Service Electric & Gas Company (PSE&G) and Towner Electric I, L.P. ("Towner Electric") negotiated buy-out of a power purchase agreement in late 1992. In the Matter of the Joint Petition of Public Service Electric and Gas Company a Towner Electric I. L.P. for Approval of a Second Amendment to Power Purchase and Interconnection Agreement. Decision and Order, Docket No. EM91040844, ("Towner"). The Towner Electric contract pricing exceeded forecasts of PSE&G's avoided costs by over $500 million of a net present value (NPV) basis for the 440 MW project; PSE&G, however, was able to terminate the contract for a buy-out payment of $18.5 million.

The Towner case brought to the forefront the concept of buying out contracts which are no longer beneficial based upon changed circumstances. The Board in its Order approving the Towne Electric buy-out, directed the other electric utilities under its jurisdiction to:

> "assess existing contracts with particular emphasis on those projects in the earliest stages of development to determine whether or not they remain economic and whether there are any candidates for exploring buy-outs or other remedial measures"; and to report back to the Board staff.

Consistent with that order, JCP&L reported to Staff that the FCA Agreement exceeded JCP&L's September 1991 avoided costs by $190 million NPV and that the project was in the early stages of development. JCP&L subsequently initiated buy-out talks with the project. Those overtures were rejected by the project.

As a result of the positions taken by JCP&L and FCA, it was clear to Staff that no agreement was going to be mutually reached between FCA and JCP&L. Staff therefore pursued directly with FCA mitigation of the Towner concerns raised by the Board and identified by JCP&L. In recognition of the apparent economic development benefits of the planned cogeneration project for the steam host (Nestle Foods) and the Township of Freehold, as well as the economic activity related to the construction and operation of the cogeneration facility and the substantial benefits for gas ratepayers attendant to the proposed gas supply contract, Staff explored price concessions directly with FCA as an alternative to a project buyout. Staff and FCA ultimately reached an agreement on price concessions intended to meet the concerns raised by the Board in its Towner Order.

These concessions were memorialized in a Joint Agreement between Staff and FCA which was filed with the Board on November 3, 1993 for its approval. At its November 10, 1993 agenda meeting, the Board formally set a schedule for written comments on the Joint Agreement as well as on the modified gas service agreement between FCA and New Jersey Natural Gas Company, which was filed on November 23, 1992 (Docket No. GM92111058). Comments and/or replies thereto were received from JCP&L, the Department of the Public Advocate-Division of Rate Counsel ("Rate Counsel"), New Jersey Natural Gas Company ("NJNG"), V.O.I.C.E., and Board Staff.

The Joint Agreement:

The Joint Agreement contains certain proposed pricing concessions by FCA. The Joint Agreement recommends that the Board in its Decision and Order approving the Joint Agreement, recommended to JCP&L that FCA and JCP&L enter into an amendment to the Agreement whereby FCA will agree to effectively lower its rates and provide other incremental benefits as set forth in the Joint Agreement in exchange for certain non-financial modifications to the Agreement.

The proposed pricing concessions included in the Joint Agreement are as follows:

(a) FCA will provide an additional 10 MW to JCP&L with no additional capacity charges and the energy priced the same as in the Agreement.

(b) FCA will lower its variable energy rate from 3.302 cents per kwh to 3.271 cents per kwh effective February 1, 2001. After January 1, 2002, the variable energy rate will escalate at 6% per year as opposed to 7% per year.

(c) The capacity payments to FCA will be reduced by $10 million per year for each of the last three years of the Agreement.

(d) FCA agrees not to sell electricity directly to either Nestle or to Interstate Waste Technologies which is developing a sludge to methanol project on an adjacent site.

FCA requested that the Board approve the Joint Agreement and find and determine that the Joint Agreement and the modifications to the power purchase agreement address all concerns about possible contract renegotiation

and/or buyout of the Agreement raised by the Board in its Towner Order and by JCP&L in its response to that Order.

Summary of Comments:

FCA argues for approval of the Joint Agreement. FCA states that it was willing to live with the terms of the original Agreement. It did not seek any modifications to the original Agreement. It has offered price concessions in an attempt to meet the Board's concerns raised in the Towner Order, not in exchange for other non-price concessions. FCA values the price concessions at approximately $50 million net present value (NPV). FCA believes the Staff, in negotiating and signing the Joint Agreement, was appropriately exercising its role of insuring that Board's policies are properly implemented.

JCP&L opposes approval of the Joint Agreement. As an alternative, JCP&L urges that the Board require FCA to demonstrate that the project is viable under current avoided costs. If FCA fails to so demonstrate, JCP&L believes the Board should require FCA to enter into negotiations with JCP&L for (a) an appropriate buy-out of the project or (b) an amendment to revise the pricing to be consistent with current avoided costs. If no agreement between JCP&L and FCA is reached within 90 days, JCP&L believes the Board should commence a proceeding to determine if the Order approving the power purchase agreement should be modified or revoked, or, in the alternative, to disallow recovery from JCP&L's customers of such portion of the costs thereunder which are found to be substantially in excess of JCP&L's current avoided costs.

In April and September of 1993, JCP&L made buy-out offers to FCA. In response to JCP&L's September offer, FCA stated that in settlement discussions with Staff had resulted in considerable progress and it was therefore inappropriate to discuss buy-out with JCP&L. JCP&L

alleges that FCA's discussions with Staff removed are incentive on FCA's part to engage in meaningful buy-out or price reduction negotiations with JCP&L.

JCP&L argues that its due process rights have been violated because of the expedited comment period established by the Board. JCP&L received the petition for approval of the Joint Agreement on November 5, 1993. On November 9, 1993, JCP&L filed a letter stating that the proposed schedule for consideration of this matter was too ambitious. Further, JCP&L requests hearings on the many factual issues which it alleges require consideration. Finally, JCP&L objects to Staff acting in an advisory capacity in this matter since it is essentially a party to a contested agreement.

JCP&L argues that the Board should not modify the terms of a freely negotiated agreement between itself and the project at the request of one party. JCP&L concedes that the Joint Agreement includes some price reductions, but contends that the purported savings are approximately $17 million NPV as opposed to the $50 million NPV estimated by FCA. Additionally, JCP&L strongly opposes the changes to other contract terms requested by FCA in exchange for the pricing concessions. Specifically, JCP&L does not believe the price concessions address the economic concerns raised in the Board's Towner Order. Therefore, it does not believe FCA should be relieved of "regulatory risks" as requested. Also, JCP&L claims that FCA is now asking to modify terms concerning assignment that JCP&L has previously refused to modify.

JCP&L contends that the proposed modified price agreement exceeds current avoided costs by approximately $1.1 billion over in term, or $350 million NPV. JCP&L does not believe the Board should take any actions which would enhance the viability of this project or relieve it of its obligations under the Board's Towner Order.

Rate Counsel urges the Board to deny the relief requested in the petition and to order the parties to renegotiate based upon current avoided costs. Further, Rate Counsel argues that the Administrative Procedures Act requires that the Board conduct evidentiary hearings prior to making a determination regarding this matter.

Rate Counsel concurs with JCP&L that even with the proposed amendments the agreement is uneconomical and will continue to impose an egregiously heavy burden on JCP&L ratepayers. Rate Counsel believes this is contrary to the Board's Towner Order, wherein the Board directed utilities to review their existing contracts to determine whether or not these contracts remain economic and explore measures that could be taken to remedy any uneconomical contract.

NJNG believes that the Board should approve both the modified gas service agreement (GSA) and the Joint Agreement between Staff and FCA. In essence, NJNG argues for approval of the Joint Agreement based on its belief that it will provide economic and environmental benefits in addition to the benefits to the customer of NJNG.

By letter dated November 15, 1993, V.O.I.C.E., an unincorporated association of residents of Freehold Township, submitted comments on the Joint Agreement and to support a Motion to Intervene. V.O.I.C.E. believes FCA is required to receive a Certificate of Need prior to constructing the facility. V.O.I.C.E. disputes many of the alleged benefits identified in FCA's petition and argues that the modified agreement is not in the best interest of ratepayers.

By letter dated November 19, 1993, FCA responded in opposition to V.0.I.C.E.'s motion. FCA contends that the V.O.I.C.E. motion:

1) fails to identify what interest, if any the V.O.I.C.E. members have in this proceeding, and

2) fails to identify how those interests are different from those represented by Rate Counsel.

FCA also argued that V.O.I.C.E.'s substantive arguments lack merit. FCA refutes V.O.I.C.E.'s argument that the FCA facility is a public utility which must obtain a Certificate of Need prior to constructing its facility.

FCA argues that the proposed facility is not a public utility, rather it is a non-utility generator which is exempt from state regulation under federal law (PURPA) and is exempt from the requirement of filing for a Certificate of Need.

With regard to the Motion to Intervene, V.O.I.C.E. has not demonstrated a direct interest in this proceeding under N.J.A.C. 1;1-16.1(a), nor has it demonstrated whether any such interest is different from that which is represented by Rate Counsel. We concur with FCA that the proposed facility is not a public utility and is therefore exempt from the requirement of filing for a Certificate of Need. Accordingly, the Motion to Intervene of V.O.I.C.E. is HEREBY DENIED.

Discussion:

Both JCP&L and Rate Counsel indicate in their comments that they were excluded from the negotiations between Staff and FCA. JCP&L, in particular, strongly criticizes the actions of Staff in this matter. Before moving to the substance of the Joint Agreement the Board will briefly address this issue.

In its response to comments, Staff explains its role in the process from the time of the filing of JCP&L's Towner response through the filing of the petition and Joint Agreement with the Board in early November. It is clear to the Board that Staff acted entirely in good faith in this matter. Contrary to the accusations of JCP&L, it appears that Staff kept the Company fully informed of the status and content of the discussions. Staff is correct in its assessment that JCP&L has limited unilateral ability to demand contract pricing concessions, to the extent that FCA is meeting all of its contractual commitments. Staff undertook a legitimate attempt to address the concerns raised in the Board's Towner Order and JCP&L's response thereto, and to procure more reasonable rates for JCP&L and its ratepayers. Rather than launching an inappropriate attack on Staff, JCP&L should have lauded the effort by Staff to attempt to reach a negotiated resolution of this issue which would have the effect of reducing rates to its customers. In the strongest possible terms, the Board rejects the unfounded attacks on Staff and other assertions that due process rights were violated.

We concur with JCP&L and Rate Counsel however, that while the Joint Agreement provides price concessions by FCA relative to the original Agreement, which somewhat improve the economics of the transaction, the revised pricing terms are still far in excess of current avoided cost forecasts. It is estimated by JCP&L that the original agreement exceeds current avoided costs by $1.215 billion, while the proposed modified agreement exceeds current avoided costs by $1.145 billion (or $370 million and $350 million NPV, respectively). Absent any further modifications, it is apparent to us that JCP&L's customers will most likely be saddled with these excessive costs for the next twenty years, were the project to proceed.

As indicated above, the Joint Agreement leaves the pricing in the Power Purchase Agreement significantly above current forecasts of avoided cost. As such, the Board does not believe it represents a reasonable resolution of this matter consistent with the concerns raised in the Board's recent Towner decision. Therefore, the Board REJECTS the Joint Agreement. The Board HEREBY ORDERS JCP&L and FCA to enter into immediate good faith negotiations to develop modifications to the Agreement to bring it more in line with current avoided costs, or, in the alternative for an appropriate buy-out of the Agreement, subject to the Board's approval. If no agreement between FCA and JCP&L is reached and submitted to the Board within thirty days of the date of this Order the Board will commence an evidentiary proceeding, pursuant to N.J.S.A. 48:2-40, to consider what actions, if any, should be taken by the Board, including modification or revocation of its Order approving the Agreement.

We would note that information has been introduced into this record which indicates that there would be substantial economical benefits for both Freehold Township and Nestle from the development of the FCA project. Specifically, Freehold Township would receive over $6 million in direct benefits, including an upgrade to its water and sewer system plus contributions to various civic projects Nestle would receive site lease benefits and energy discounts estimated to be worth $2 million per year. We therefore urge the parties to include in their discussion mechanisms which would preserve the benefits to Nestle and the Township which have been anticipated in reliance upon the development of this project.

The substantial magnitude of the apparent economic disbenefit associated with the existing Agreement combined with the fact that the project is in the relatively early stages of development warrants our deep concern and resultant

directive to the parties to negotiate modifications to the Agreement or a buy-out, consistent with the Board's regulatory oversight obligations. If the parties work together, we are hopeful that significant savings to ratepayers can be achieved while maintaining the benefits for Freehold Township and Nestle and at the same time allowing FCA to continue with the project with prices more consistent with current avoided costs or, in the alternative, working out an appropriate project termination which leaves all parties whole. Thus, the Board is giving the parties an opportunity to try to craft such an agreement in a manner which is least disadvantageous to all parties. However, the Board is putting JCP&L and FCA on notice that if they cannot reach agreement on either reasonable renegotiated pricing terms more consistent with current avoided costs or a buy-out arrangement within 30 days, the Board is prepared to commence a proceeding to consider whether its previous approval of this Agreement should be modified or otherwise reconsidered or revoked.

Finally, the Board does not believe it is appropriate to make a determination concerning the gas service agreement until such time as the issues concerning the power purchase agreement have been resolved. On that basis, the Board will defer action on the gas service agreement until the issues

concerning the power purchase agreement have been resolved.

DATED: January 5, 1994

BOARD OF REGULATORY COMMISSIONERS BY:

/s/

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CHAIRMAN

/s/

JEREMIAH F. O'CONNOR
COMMISSIONER

/s/

CARMEN J. ARMENTI
COMMISSIONER

ATTEST:

/s/

IRENE JOHNSON
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